

# **COMMODITY FUTURES TRADING COMMISSION**

**17 CFR Parts 41 and 140**

**RIN 3038–AB82**

## **Designated Contract Markets in Security Futures Products: Notice-Designation Requirements, Continuing Obligations, Applications for Exemptive Orders, and Exempt Provisions.**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission hereby adopts new regulations providing notice procedures for a national securities exchange, a national securities association, or an alternative trading system to become a designated contract market in security futures products, in accordance with the Commodity Futures Modernization Act of 2000. Such notice-designated contract markets would be subject to certain limited filing requirements, based on various provisions of the Commodity Exchange Act. Notice-designated contract markets may apply for exemptive relief from any section of the Commodity Exchange Act or regulations thereunder, to the extent such an exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

**EFFECTIVE DATE:** August 21, 2001.

**FOR FURTHER INFORMATION CONTACT:** Joshua R. Marlow, Attorney-Advisor, or David P. Van Wagner, Associate Director, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21<sup>st</sup> Street, N.W., Washington, D.C. 20581, (202) 418-5490, electronic mail: [jmarlow@cftc.gov](mailto:jmarlow@cftc.gov) or [dvanwagner@cftc.gov](mailto:dvanwagner@cftc.gov).

## SUPPLEMENTARY INFORMATION:

### I. Background

The Commodity Futures Modernization Act of 2000 (“CFMA”)<sup>1</sup> amended the Commodity Exchange Act (“Act”) to permit the trading of security futures products,<sup>2</sup> subject to the joint jurisdiction of the Commodity Futures Trading Commission (“Commission” or “CFTC”) and the Securities and Exchange Commission (“SEC”).<sup>3</sup> Security futures products may be traded on any board of trade either designated as a contract market (“DCM”) by the Commission pursuant to section 5 of the Act or registered with the Commission as a derivatives transaction execution facility (“DTF”) pursuant to section 5a of the Act.<sup>4</sup>

Alternatively, section 5f of the Act permits certain entities that are otherwise regulated by the SEC to become designated contract markets for the limited purpose of trading security futures products.<sup>5</sup> Specifically, any board of trade registered with the SEC as a national securities exchange pursuant to section 6(a) of the ‘34 Act or as a national securities association pursuant to section 15A(a) of the ‘34 Act, or that operates as an alternative trading system

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<sup>1</sup> Pub. L. No. 106-554, 114 Stat. 2763 (December 21, 2000).

<sup>2</sup> The term “security futures product” is defined in section 1a(32) of the Act to mean “a security future or any put, call, straddle, option, or privilege on any security future.” The term “security future” is defined in section 1a(31) of the Act and specifically excludes, among other things, “excluded swap transactions” (as defined in section 2(g) of the Act). Because the CFMA also provides that options on security futures cannot be traded until at least December 21, 2003, security futures are the only security futures products that may be available for trading before such date. See section 2(a)(1)(D)(iii)(II) of the Act.

<sup>3</sup> See section 251(a)(2) of the CFMA. Prior to passage of the CFMA, section 2(a)(1)(B)(v) of the Act prohibited the trading of security futures products.

<sup>4</sup> The CFMA prescribes certain dates before which trading in security futures products shall not commence. Specifically, trading on a principal-to-principal basis between eligible contract participants (“ECPs”) was not permissible prior to August 21, 2001, and retail trading may not begin until December 21, 2001. However, both of these dates are conditioned upon the registration of a futures association as a national securities association under the Securities Exchange Act of 1934 (“‘34 Act”). See section 202(a)(5) of the CFMA and section 6(g)(5) of the ‘34 Act.

<sup>5</sup> See section 252(a)(2) of the CFMA.

(“ATS”) as defined by section 1a(1) of the Act, shall be a designated contract market in security futures products (“SFPCM”) if:

- (1) such national securities exchange, national securities association, or alternative trading system lists or trades no other contracts of sale for future delivery, except for security futures products;
- (2) such national securities exchange, national securities association, or alternative trading system files written notice with the Commission in such form as the Commission, by rule, may prescribe containing such information as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of customers; and
- (3) the registration of such national securities exchange, national securities association, or alternative trading system is not suspended pursuant to an order by the Securities and Exchange Commission.<sup>6</sup>

The designation “shall be effective contemporaneously with the submission of notice ... to the Commission.”<sup>7</sup> Moreover, section 5f(b)(4) of the Act permits the Commission to exempt SFPCMs from any provision of the Act or regulations thereunder, and requires that the Commission determine procedures which would allow SFPCMs to apply to the Commission for such an exemption, “to the extent [any] such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.”

Accordingly, on May 31, 2001, the Commission proposed new regulations 41.31, 41.32, 41.33, and 41.34, which would apply to boards of trade seeking notice-designation as an SFPCM.<sup>8</sup> In addition to these rule proposals, the Commission sought comment on a variety of related issues, including a potential disparity between the Commission’s proposed notice-

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<sup>6</sup> Section 5f(a) of the Act.

<sup>7</sup> Id.

<sup>8</sup> See 66 FR 29517 (May 31, 2001). The comment period expired on July 2, 2001.

designation procedures and related notice-registration procedures proposed by the SEC. The Commission received two comment letters.<sup>9</sup>

## **II. Final Rules**

### *A. Regulation 41.1 – Definitions*

To implement the procedures identified in regulations 41.31 through 41.34, the Commission proposed to establish regulation 41.1, which would contain six definitions: “alternative trading system”; “board of trade”; “national securities association”; “national securities exchange”; “rule”; and “security futures product.” The definitions of “alternative trading system,” “board of trade,” and “security futures product” would be taken verbatim from section 1a of the Act. The terms “national securities exchange” and “national securities association” would have the same meanings as in the ’34 Act, and the definition of “rule” would be identical to the definition found in Commission regulation 40.1.<sup>10</sup> No comments were received regarding this rule, and the Commission has determined to adopt it as proposed.

### *B. Regulation 41.31 – Notice-designation*

Section 5f(a)(2) of the Act states that a board of trade may obtain designation as a contract market in security futures products by filing “written notice with the Commission in such form as the Commission, by rule, may prescribe containing such information as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of customers.” The Commission therefore proposed new regulation 41.31, which would establish notice-designation procedures for any board of trade which operates as a

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<sup>9</sup> Comments were provided by the Chicago Board of Trade (“CBT”) on July 2, 2001, and by the American Stock Exchange (“AMEX”) on July 12, 2001.

<sup>10</sup> See 66 FR 42256 (Aug. 10, 2001). Commission regulations referred to herein are found at 17 CFR Ch. I (2000).

national securities exchange, national securities association, or alternative trading system and which seeks designation as an SFPCM.

The proposed content requirements of the notice include contact information, a description of the security futures products that would be traded, a copy of the rules of the board of trade, and five certifications derived from various requirements found in sections 5f and 2(a)(1)(D)(vii) of the Act.<sup>11</sup> The Commission believes that this information is necessary in order to maintain communication with a board of trade and to receive information about its operations, two functions that are “necessary or appropriate in the public interest or for the protection of customers.” CBT is supportive of this proposed rule, stating that the Commission’s approach is “reasonable and consistent with the intent of the CFMA.”<sup>12</sup> The Commission has determined to adopt regulation 41.31 as proposed.<sup>13</sup>

### *C. Regulation 41.32 – Continuing obligations*

Proposed regulation 41.32 would establish a mechanism for the Commission to receive the following from an SFPCM:

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<sup>11</sup> Section 2(a)(1)(D)(vii) of the Act states: “It shall be unlawful for a board of trade to trade or execute a security futures product unless the board of trade has provided the Commission with a certification that the specific security futures product and the board of trade, as applicable, meet the criteria specified in subclauses (I) through (XI) of [section 2(a)(1)(D)(i)], except as otherwise provided in [section 2(a)(1)(D)(vi)].”

<sup>12</sup> CBT’s comment in this regard was a response to both the Commission’s proposed regulation 41.31 and the request for comment regarding the potential disparity between the proposed notice-designation procedures and the related SEC notice-registration procedures.

<sup>13</sup> If a board of trade previously filed documents with the SEC containing information that satisfies any of these requirements, the Commission would accept copies of such documents in lieu of the required information.

The Commission intends to amend regulation 41.31(a)(5)(iii) so that it cross-references regulations 41.22 and 41.23, rather than the Act, should regulations 41.22 and 41.23 become final. Proposed regulations 41.22 and 41.23 would establish listing standards for the trading of security futures products, pursuant to section 2(a)(1)(D)(i) and (vii) of the Act. See 66 FR 37932 (July 20, 2001).

- (1) notification of any change in its regulatory status with the SEC or with a futures association registered under section 17 of the Act;<sup>14</sup>
- (2) a certification consistent with the requirements of section 2(a)(1)(D)(vii) of the Act each time the board of trade lists a new security futures product for trading;<sup>15</sup>
- (3) a copy of any new rules or rule amendments that relate to the trading of security futures products, including any operational rules and the terms and conditions of any security futures products;<sup>16</sup>
- (4) upon request, information related to its business as a designated contract market in security futures products; and
- (5) upon request, a written demonstration, including supporting data, that the board of trade is in compliance with a specified provision of the Act or regulations thereunder.

This information would facilitate the Commission's efforts in carrying out its market oversight responsibilities under the Act and would help ensure that SFPCMs continue to comply with the conditions of designation under section 5f(a) of the Act and regulation 41.31.<sup>17</sup>

As stated in the proposing release,<sup>18</sup> these requirements are authorized by various recordkeeping and reporting provisions of the Act that are applicable to all designated contract markets. In particular, section 4g(b) of the Act requires that "[e]very registered entity ...

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<sup>14</sup> A change in regulatory status includes, among other things, suspension of registration pursuant to an order by the SEC, a switch in SEC registration from "alternative trading system" to "national securities exchange," or suspension or revocation of membership by a registered futures association.

<sup>15</sup> *See supra* note 11.

<sup>16</sup> A change in the clearing facilities utilized by an SFPCM would be included in this category.

<sup>17</sup> As is the case under regulation 41.31, if a board of trade previously filed documents with the SEC which contain information satisfying any of these proposed informational requirements, the Commission would accept copies of such documents in lieu of the required information.

<sup>18</sup> *See* 66 FR 29517 at 29519.

maintain daily trading records ... includ[ing] such information as the Commission shall prescribe by rule,”<sup>19</sup> and section 4g(d) of the Act continues, “[d]aily trading records shall be maintained in a form suitable to the Commission ... . Reports shall be made from the records maintained ... in such form as the Commission may prescribe.” Moreover, sections 8(a)(1) and 2(a)(1)(D)(iv)(I) of the Act, respectively, permit the Commission to “make such investigations as it deems necessary to ascertain the facts regarding the operations of boards of trade ... subject to the provisions of this Act” and to make “such reasonable periodic or special examinations ... as the Commission deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act.”<sup>20</sup> Under section 3 of the Act, the Commission also has general responsibilities to prevent manipulation and other disruptions to market integrity, to ensure the financial integrity of all transactions subject to the Act, and to protect all market participants from fraud.

The Commission stated in the proposing release, and reiterates now, that regulation 41.32 is not an exhaustive list of SFPCM regulatory requirements meant to supplant SFPCMs’ statutory and other regulatory obligations.<sup>21</sup> AMEX commented that SFPCMs would face regulatory uncertainties because the Commission “did not identify the particular ... regulations

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<sup>19</sup> The term “registered entity” is defined by Section 1a(29) of the Act to include DCMs, DTFs, derivatives clearing organizations, and SFPCMs.

<sup>20</sup> The Commission’s authority under section 2(a)(1)(D)(iv)(I) of the Act is subject to certain limitations appearing later in that provision.

<sup>21</sup> For example, the Commission emphasized in the proposing release that an SFPCM would be subject to the requirements of Part 16 of the Commission’s regulations, but that the Commission would endeavor to limit its requests to information deemed necessary for routine market surveillance. The Commission also noted that an SFPCM would be required to grant the Commission access to any books and records relating to transactions conducted in reliance on its designation as an SFPCM, pursuant to sections 4(a)(3), 4(b), 4g(b), and 4g(d) of the Act and Commission regulation 1.31. (Regulation 1.31 has been reserved by the Commission’s recent regulatory reform rulemaking. See 66 FR 42256 at 42277.)

with which SFPCMs were expected to comply.”<sup>22</sup> Because AMEX’s concern in this instance is bound up with its concerns over proposed regulation 41.34, the Commission will address the AMEX comment below in section II.D. AMEX did not, however, take issue with any of the particular requirements of regulation 41.32, and the Commission has decided to adopt regulation 41.32 in substantially the same form as proposed.<sup>23</sup>

Additionally, the proposing release noted the Commission’s authority under Section 4i of the Act to collect information on the positions of large traders.<sup>24</sup> This information ordinarily is provided to the Commission by futures commission merchants (“FCMs”), clearing members, and foreign brokers, pursuant to Part 17 of the Commission’s regulations. Because Part 17 will apply to the trading of security futures products, but might fail to capture large trader information under certain circumstances, the Commission requested comment on amending Part 17.<sup>25</sup> No

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<sup>22</sup> CBT was generally supportive of regulation 41.32.

<sup>23</sup> Proposed regulation 41.32 has been modified in two respects. The Commission has determined to delete the first eight words from proposed regulation 41.32(a)(3). This deletion is made in order to eliminate any potential confusion regarding the inapplicability of Part 40 to SFPCMs, discussed *infra* section II.D. The Commission also added a clause to paragraph (a) to note that all filings made pursuant to regulation 41.32(a) shall be addressed to the Commission’s Secretary at its Washington, D.C. headquarters. The latter change necessitated a renumbering of the clauses in paragraph (a).

The Commission intends to amend regulation 41.32(a)(1)(ii) so that it cross-references regulations 41.22 and 41.23, rather than the Act, should regulations 41.22 and 41.23 become final. Proposed regulations 41.22 and 41.23 would establish listing standards for the trading of security futures products, pursuant to section 2(a)(1)(D)(i) and (vii) of the Act. See 66 FR 37932 (July 20, 2001).

<sup>24</sup> Section 4i of the Act prohibits any person to “have or obtain a long or short position in any commodity or any future of such commodity equal to or in excess of such amount as shall be fixed from time to time by the Commission, unless such person files or causes to be filed with the properly designated officer of the Commission such reports regarding any [such] transactions or positions ... as the Commission may by rule or regulation require.”

<sup>25</sup> For example, if an ATS operates a non-intermediated marketplace and notice-designates as an SFPCM, it is not clear who would be responsible for providing to the Commission any large trader information arising out of security futures product transactions conducted on that marketplace. The Commission therefore requested comment on amending Part 17 so that, in such circumstances, the ATS itself would be required to provide large trader position information that otherwise would be provided by an FCM.



comments were received on this issue. The Commission plans to address this issue separately in the near future.<sup>26</sup>

*D. Regulations 41.33(a)-(f), 41.34, and 140.99 – Exemptions*

Section 5f(b)(4)(A) of the Act provides that the Commission “by rule, regulation or order, may conditionally or unconditionally exempt” any board of trade designated as an SFPCM from any provisions of the Act or regulations thereunder, to the extent that the exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. Section 5f(b)(4)(B) directs the Commission to determine the procedures by which an exemptive order under section 5f(b)(4)(A) shall be granted, and vests the Commission with sole discretion to decline to entertain any application for such an order.

Accordingly, the Commission proposed regulation 41.33, which would require an SFPCM seeking an exemption to file an application with the Commission containing various information, including: the name and address of the SFPCM requesting relief, and a contact person at the SFPCM; a certification that the SEC registration of the SFPCM is not suspended pursuant to an order of the SEC; an identification of the provision(s) from which the SFPCM is requesting relief and, if applicable, whether the SFPCM is subject to similar SEC provisions; the type of relief sought; and an explanation of the need for relief, including the extent to which such relief is necessary or appropriate in the public interest and consistent with the protection of investors.

The Commission proposed that it would have 90 days to review the application, but could stay the review period at any time if it determined that the application was materially incomplete.

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<sup>26</sup> The Commission also requested comment on whether there are other potential circumstances under which large trader position information might not be captured by Part 17, in its current form, particularly in light of this rulemaking. No comments were received. The Commission will address this issue when a need arises.

Moreover, the Commission could, in its sole discretion, decline to entertain an application for any reason, without explanation, at any time during the review period. These exemptive order procedures would become an enumerated exception to the applicability of Commission Regulation 140.99, which governs generally the form and manner of requests for exemptive letters.

AMEX objected to the discretion that would be afforded Commission staff under this exemption process.<sup>27</sup> It asserted that the Commission should modify proposed regulation 41.33:

- (1) to *require* Commission review of SFPCM requests for exemptive orders using the CFMA standard, that is, the “necessary or appropriate in the public interest and is consistent with the protection of investors” standard; and
- (2) to *require* the preparation of a written explanation upon request of the reasons for a denial of a request for an exemptive order.<sup>28</sup>

(emphasis in original)

The Commission notes that proposed regulation 41.33(a) already requires that requests for exemptive orders be reviewed using the CFMA standard. Moreover, paragraphs (b) and (e) of proposed regulation 41.33 would require that the Commission notify the board of trade of any decision in writing. The Commission believes that this is appropriate in light of section 5f(b)(4)(B) of the Act, which states that “the Commission shall, by rule or regulation, determine the procedures under which an exemptive order under this section is granted and may, in its sole discretion, decline to entertain any application for an order of exemption under this section.” This grant of exemptive authority by Congress gives the Commission “sole discretion” whether

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<sup>27</sup> CBT did not comment on this proposed rule.

<sup>28</sup> This argument was made in the alternative. AMEX’s primary objection, addressed below, is that the Commission should publish “a comprehensive list of rules that SFPCMs should comply with.” AMEX believes that if the Commission does not publish such a list, it should seek to minimize the discretion afforded Commission staff in the exemptive order application process.

to decline to entertain exemptive order applications. If the Commission were to bind itself to a requirement that a written explanation be provided, it would effectively undermine its authority to decline to entertain an application; a formal, written explanation under such circumstances would be indistinguishable from a denial of the application. In order to maintain conformity between the statutory and regulatory provisions, the Commission has determined that it will adopt regulation 41.33 as proposed.<sup>29</sup> Nonetheless, as discussed below, the Commission welcomes any suggestions concerning potential exemptions, and is committed to providing a thorough, expeditious review to any petitions filed pursuant to these provisions.

The Commission also proposed regulation 41.34, which would list the provisions of the Act from which SFPCMs would be exempted. Paragraph (a) lists each of the statutory provisions enumerated in section 5f(b)(1) of the Act.<sup>30</sup> Paragraph (b), which originally contained only section 6(a) of the Act,<sup>31</sup> has been expanded to include Parts 38 and 40 of the regulations.<sup>32</sup>

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<sup>29</sup> Adoption of regulation 41.33 includes an associated amendment to Commission regulation 140.99, which makes applications for exemptive orders submitted pursuant to regulation 41.33 an exception to the procedures identified in regulation 140.99.

<sup>30</sup> Section 5f(b)(1) of the Act states—

A national securities exchange, national securities association, or alternative trading system that is designated as a contract market pursuant to section 5f shall be exempt from the following provisions of this Act and the rules thereunder:

- (A) Subsections (c), (e), and (g) of section 4c.
- (B) Section 4j.
- (C) Section 5.
- (D) Section 5c.
- (E) Section 6a.
- (F) Section 8(d).
- (G) Section 9(f).
- (H) Section 16.

<sup>31</sup> Section 6(a) of the Act addresses the application process applicable to DCMs and DTFs.

<sup>32</sup> See 66 FR 42256 (Aug. 10, 2001) (promulgating, among other things, Parts 38 and 40 of the Commission's regulations). Although proposed regulation 41.34(b) only included section 6(a) of the Act, the proposing release discussed the inapplicability of parts 38 and 40 to SFPCMs. See 66 FR 29517 at 29520. No comments were received regarding the Commission's proposal to exempt SFPCMs from section 6(a) of the Act or the Commission's discussion of Parts 38 and 40 generally.

Because SFPCMs are exempted from sections 5 and 5c of the Act,<sup>33</sup> which are the source for much of the authority for Parts 38 and 40, the Commission has modified regulation 41.34 to reflect that SFPCMs also are exempt from the provisions of Parts 38 and 40.<sup>34</sup>

Regarding paragraph (a) of proposed regulation 41.34, AMEX commented that the Commission did not identify the particular regulations with which SFPCMs were expected to comply.<sup>35</sup> AMEX also noted that it may be difficult to ascertain which Commission requirements were promulgated pursuant to provisions of Act from which SFPCMs are exempt. The Commission understands this predicament, and requested comment on precisely these two issues.<sup>36</sup> However, no commenters, including AMEX, offered any specific examples of which Commission requirements were duplicative of SEC obligations.

As discussed above, the Commission has identified section 6(a) of the Act and Parts 38 and 40 of the regulations as additional provisions from which SFPCMs are exempted. Moreover, in the spirit of the general intent of the CFMA to reduce the burdens of shared jurisdiction, the Commission remains open to suggestions regarding any provisions from which SFPCMs should be exempted.<sup>37</sup> The Commission believes that SFPCMs are in the best position to determine

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<sup>33</sup> See *supra* note 30.

<sup>34</sup> Moreover, regulation 38.1, addressing the “scope” of Part 38 generally, states that “[t]he provisions of this part 38 shall apply to every board of trade or trading facility that has been designated as a contract market in a commodity under section 6 of the Act.” Because other paragraphs under section 6 remain applicable to SFPCMs, the Commission believes that specifically exempting SFPCMs from section 6(a) of the Act further clarifies that Part 38 is inapplicable to SFPCMs.

<sup>35</sup> CBT did not comment on this proposed rule.

<sup>36</sup> “In addition to the proposals above, the Commission seeks comment from boards of trade and other interested persons regarding whether there are any other provisions of the Act or regulations thereunder from which SFPCMs should be exempt by regulation. The Commission is particularly interested in commenters’ views regarding, among other things, the interplay between the enumerated exemptions in sections 5f(b)(1) and (2) of the Act and the Commission’s regulations generally.” 66 FR 29517 at 29520.

<sup>37</sup> The Commission notes that no comments were received regarding which provisions a notice-designated ATS might be appropriately exempted from pursuant to section 5f(b)(2) of the Act. See 66 FR 29517 at note 27. The Commission also remains open to suggestions on this matter.

which Commission requirements are duplicative of their other regulatory obligations.

Accordingly, regulation 41.34(a) will be adopted as proposed. Commission staff is always available to consult with any board of trade that seeks or accomplishes notice-designation and is unsure of its regulatory and compliance responsibilities.

*E. Regulation 41.33(g) – Delegation of authority*

Finally, the Commission proposed to delegate to the Director of the Division of Trading and Markets and the Director of the Division of Economic Analysis, jointly, with the concurrence of the Commission's General Counsel, the authority to grant or deny applications for exemptive orders under regulation 41.33. This delegation of authority is intended to expedite the procedures described in proposed regulation 41.33 and to place responsibility for them with those Commission staff members most directly involved in the relevant matters. No comments were received on this issue, and the Commission will adopt the delegation of authority as proposed. The Commission believes that this delegation will maximize regulatory efficiency with respect to the processing of regulation 41.33 exemption applications.

### **III. Administrative Procedure Act**

Section 553(d) of the Administrative Procedure Act generally provides that a substantive rule may not be made effective less than 30 days after notice is published in the Federal Register.<sup>38</sup> One exception to the 30-day requirement, among others, is an agency's finding of good cause for providing a shorter effective date.

The CFMA provides that principal-to-principal transactions in security futures products between ECPs may commence on August 21, 2001.<sup>39</sup> Prior to passage of the CFMA, there was

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<sup>38</sup> See 5 U.S.C. 553(d).

<sup>39</sup> See *supra* note 4.

no need for the Commission to have rules providing for the expedited designation of certain boards of trade as contract markets in security futures products. Since passage of the CFMA, the Commission has moved quickly to adopt rules that would facilitate notice-designation. The Commission, after reviewing and considering the comments received, is now adopting these rules in substantially the same form as proposed. By allowing certain principal-to-principal transactions to commence on August 21, 2001, Congress, in essence, established a statutory deadline for the promulgation of these rules. If the effective date is delayed for 30 days, then those boards of trade that wish to notice-designate as contract markets in security futures products would not be able to begin listing products for trading, assuming the various other conditions<sup>40</sup> for the commencement of trading would have been met before the 30 days expired.

The primary purpose of delaying effectiveness of new rules for 30 days is to give affected parties a reasonable period of time to adjust. In this instance, parties that might be affected would not be harmed by immediate effectiveness of the rules because they would only be subject to the rules voluntarily. Moreover, to the extent that these rules have been promulgated in substantially the same form as the proposed rules and were published for comment, any affected boards of trade are already familiar with the rules. Finally, the 30-day delay in effectiveness could interfere with the goals and mandates of the CFMA. Therefore, the Commission concludes that there is good cause for making these rules effective immediately upon publication.

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<sup>40</sup> Id.

## IV. Related Matters

### *A. Regulatory Flexibility Act*

The Regulatory Flexibility Act (“RFA”)<sup>41</sup> requires that agencies, in proposing regulations, consider the impact of those regulations on small businesses. The regulations discussed herein affect boards of trade seeking to be designated as contract markets in security futures products under notice procedures promulgated pursuant to section 5f(a) of the Act. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its regulations on such entities in accordance with the RFA.<sup>42</sup> The Commission determined that contract markets are not small entities for the purpose of the RFA.<sup>43</sup>

The Commission further notes that section 252 of the CFMA requires the Commission to promulgate these regulations. Moreover, the regulations promulgated herein would not impose any new burdens upon entities seeking to be designated as an SFPCM pursuant section 5f(a) of the Act. Rather, these regulations would facilitate exemptive relief from the more burdensome requirements in sections 5 and 5a of the Act, and regulations thereunder, that otherwise would be applicable to entities seeking to list security futures products for trading. Therefore, the Commission believes that the adoption of these regulations reduces the burden of compliance by such entities.

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<sup>41</sup> See 5 U.S.C. 601 *et seq.* (1994 and Supp. II 1996).

<sup>42</sup> See 47 FR 18618 (April 30, 1982).

<sup>43</sup> See 47 FR 18618 at 18619-20.

Accordingly, the Acting Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the regulations herein will not have a significant economic impact on a substantial number of small entities.

*B. Paperwork Reduction Act*

This rulemaking contains information collection requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>44</sup> As required by the PRA, the Commission has submitted a copy of this part to the Office of Management and Budget (“OMB”) for its review. In response to the Commission’s invitation in the notice of proposed rulemaking to comment on any potential paperwork burdens associated therewith, no comments were received.

The final rules do not contain any disclosure requirements or any consumer reporting requirements. It does, however, require the collection of certain information from boards of trade seeking to be notice-designated as contract markets in security futures products, and from notice-designated contract markets in security futures products which seek an exemption from the Act or regulations thereunder. The Commission may not conduct or sponsor, and a person is not required to respond to, an information collection unless it displays a currently valid OMB control number. The Commission has received a control number for this information collection from OMB.

*C. Cost-Benefit Analysis*

Section 15 of the Act, as amended by section 119 of the CFMA, requires the Commission, before promulgating a new regulation under the Act, to consider the costs and benefits of the Commission's action. The Commission recently applied the cost-benefit

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<sup>44</sup> See 44 U.S.C. 3501 et seq.



provisions of section 15 for the first time with respect to a final rulemaking,<sup>45</sup> and understands that although section 15, as amended, requires the Commission to consider the costs and benefits of a new regulation, it does not require the Commission to quantify those costs and benefits or determine whether the benefits of the regulation outweigh its costs.

The amended Section 15 further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery;<sup>46</sup> (4) sound risk management practices; and (5) other public interest considerations. The Commission may, in its discretion, give greater weight to any one of the five enumerated areas of concern and may, in its discretion, determine that, notwithstanding its costs, a particular regulation was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The main areas of concern relevant to this rulemaking are the first two set forth in the Act, “protection of market participants and the public” and “efficiency, competitiveness and financial integrity of the futures markets.” The Commission notes that the CFMA specifically mandates that certain boards of trade be notice-designated by the Commission as a contract market if they seek to list or trade security futures products only, and that procedures be established by the Commission for such entities to apply for exemptions from the Act or regulations thereunder. Further, the Commission believes that these additional registrants may promote the efficiency and competitiveness of those futures markets on which security future products may be traded and, in turn, may serve to promote the financial integrity of those

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<sup>45</sup> See 66 FR 20740 (Apr. 25, 2001).

<sup>46</sup> Price discovery is not a concern relevant to this rulemaking.

markets. The Commission has endeavored to impose minimal costs – i.e., only necessary disclosure and recordkeeping – on any of the entities involved, so that the benefits of the notice-designation and exemptive processes intended by Congress can be fully realized. Furthermore, submission of an application for exemptive relief is not required of SFPCMs, but elected on a voluntary basis.

AMEX commented that the costs and benefits of applying the Commission’s regulations to SFPCMs should have been assessed in the proposed rulemaking. The Commission notes that SFPCMs’ exposure to CFTC regulatory requirements has been imposed by Congress, by virtue of its passage of CFMA, rather than as a result of this rulemaking. The applicability of Commission regulations to SFPCMs is implicit in section 5f(b) of the Act, which exempts SFPCMs from only a limited number of provisions of the Act and regulations thereunder. If Congress intended that SFPCMs be exempt from additional provisions of the Act and regulations thereunder, the list of enumerated exemptions in section 5f(b)(1) would have been longer. Moreover, the fact that Congress contemplated procedures to exempt SFPCMs “from any provision of this Act or of any rule or regulation thereunder”<sup>47</sup> further demonstrates that it intended for any requirements not enumerated under section 5f(b)(1) to apply initially. Therefore, the Commission disagrees that SFPCMs are subjected to new regulatory requirements as a result of this rulemaking; the imposition of any new regulatory requirements result directly from passage of the CFMA.

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<sup>47</sup> See section 5f(b)(4) of the Act.

## List of Subjects

### *17 CFR Part 41*

Contract markets, reporting and recordkeeping requirements, security futures products.

### *17 CFR Part 140*

Authority delegations.

For the reasons discussed in the preamble, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

1. The heading for Part 41 is revised to read as follows:<sup>48</sup>

## **PART 41 – SECURITY FUTURES PRODUCTS**

2. The authority citation for Part 41 is revised to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 2a, 4, 6f, 6j, 7a-2, 7b, 12a.

3. Section 41.1 is amended by adding paragraphs (a) and (b) and (f) through (i) as follows:

### **§41.1 Definitions.**

For purposes of this part:

(a) *Alternative trading system* shall have the meaning set forth in section 1a(1) of the Act.

(b) *Board of trade* shall have the meaning set forth in section 1a(2) of the Act.

\* \* \* \* \*

(f) *National securities association* means a board of trade registered with the Securities and Exchange Commission pursuant to section 15A(a) of the Securities Exchange Act of 1934.

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<sup>48</sup> This revision supersedes the part heading added on August 10, 2001, which was to become effective October 9, 2001. See 66 FR 42256.

(g) *National securities exchange* means a board of trade registered with the Securities and Exchange Commission pursuant to section 6(a) of the Securities Exchange Act of 1934.

(h) *Rule* shall have the meaning set forth in section 40.1 of this chapter.

(i) *Security futures product* shall have the meaning set forth in section 1a(32) of the Act.

4. Subpart D, §§41.31 through 41.34, is added as follows:

#### **Subpart D—Designated Contract Markets in Security Futures Products**

**Sec.**

**41.31 Notice-designation requirements.**

**41.32 Continuing obligations.**

**41.33 Applications for exemptive orders.**

**41.34 Exempt provisions.**

#### **Subpart D—Notice-Designated Contract Markets in Security Futures Products**

##### **§41.31 Notice-designation requirements.**

(a) Any board of trade that is a national securities exchange, a national securities association, or an alternative trading system, and that seeks to operate as a designated contract market in security futures products under section 5f of the Act, shall so notify the Commission. Such notification shall be filed with the Secretary of the Commission at its Washington, D.C. headquarters, in either electronic or hard copy form, shall be labeled as “Notice of Designation as a Contract Market in Security Futures Products,” and shall include:

- (1) the name and address of the board of trade;
- (2) the name and telephone number of a contact person designated to receive communications from the Commission on behalf of the board of trade;
- (3) a description of the security futures products that the board of trade intends to make available for trading, including an identification of all facilities that would clear transactions in security futures products on behalf of the board of trade;

(4) a copy of the current rules of the board of trade; and

(5) a certification that the board of trade--

(i) will not list or trade any contracts of sale for future delivery, except for security futures products;

(ii) is registered with the Securities and Exchange Commission as a national securities exchange, national securities association, or alternative trading system, and such registration is not suspended pursuant to an order by the Securities and Exchange Commission;

(iii) will meet the criteria specified in subclauses (I) through (XI) of section 2(a)(1)(D)(i) of the Act, except as otherwise provided in section 2(a)(1)(D)(vi) of the Act, for each specific security futures product that the board of trade intends to make available for trading;

(iv) will comply with the conditions for designation under this section and section 5f of the Act, including a specific representation by any alternative trading system that it is a member of a futures association registered under section 17 of the Act; and

(v) will comply with the continuing obligations of section 41.32 of this chapter.

(b) A board of trade which files notice with the Commission under this section shall be deemed a designated contract market in security futures products upon the Commission's receipt of such notice. Accordingly, the Commission shall send prompt acknowledgment of receipt to the filer.

(c) Designation as a contract market in security futures products pursuant to this section shall be deemed suspended if the board of trade:

(1) lists or trades any contracts of sale for future delivery, except for security futures products; or

(2) has its registration as a national securities exchange, national securities association, or alternative trading system suspended pursuant to an order by the Securities and Exchange Commission.

**§41.32 Continuing obligations.**

(a)(1) A board of trade designated as a contract market in security futures products pursuant to section 41.31 of this chapter shall:

(i) notify the Commission of any change in its regulatory status with the Securities and Exchange Commission or with a futures association registered under section 17 of the Act;

(ii) comply with the filing requirements of section 2(a)(1)(D)(vii) of the Act each time the board of trade lists a security futures product for trading;

(iii) provide the Commission with any new rules or rule amendments that relate to the trading of security futures products, including both operational rules and the terms and conditions of products listed for trading on the facility, promptly after final implementation of such rules or rule amendments; and

(iv) upon request, file promptly with the Commission--

(A) such information related to its business as a designated contract market in security futures products as the Commission may request; and

(B) a written demonstration, containing such supporting data and other information and documents as the Commission may specify, that the board

of trade is in compliance with one or more applicable provisions of the Act or regulations thereunder as specified in the request.

(2) Any information filed pursuant to paragraph (a) of this section shall be addressed to the Secretary of the Commission at its Washington, D.C. headquarters, shall be labeled “SFPCM Continuing Obligations,” and may be transmitted in either electronic or hard copy form.

(b) Except as exempted under section 5f(b) of the Act or §§41.33 and 41.34 of this chapter, any board of trade designated as a contract market in security futures products pursuant to section 41.31 of this chapter shall be subject to all applicable requirements of the Act and regulations thereunder. Failure to comply shall subject the board of trade to Commission action under, among other provisions, sections 5e and 6(b) of the Act.

#### **§41.33 Applications for exemptive orders.**

(a) Any board of trade designated as a contract market in security futures products pursuant to §41.31 of this chapter may apply to the Commission for an exemption from any provision of the Act or regulations thereunder. Except as provided in sections 5f(b)(1) and 5f(b)(2) of the Act, the Commission shall have sole discretion to exempt a board of trade, conditionally or unconditionally, from any provision of the Act or regulations thereunder pursuant to this section. The Commission may issue such an exemptive order in response to an application only to the extent it finds, after review, that the issuance of an exemptive order is necessary or appropriate in the public interest and is consistent with the protection of investors.

(b) Each application for exemptive relief must comply with the requirements of this section. The Commission may, in its sole discretion, decline to entertain any application for an exemptive

order under this section without explanation; *provided, however*, that the Commission shall notify the board of trade of such a decision in writing.

(c) Application Requirements. (1) Each application for an exemptive order made pursuant to this section must include:

- (i) the name and address of the board of trade requesting relief, and the name and telephone number of a person whom Commission staff may contact to obtain additional information regarding the request;
- (ii) a certification that the registration of the board of trade is not suspended pursuant to an order of the Securities and Exchange Commission;
- (iii) the provision(s) of the Act or regulations thereunder from which the board of trade seeks relief and, if applicable, whether the board of trade is otherwise subject to similar provisions as a result of Securities and Exchange Commission jurisdiction; and
- (iv) the type of relief requested and the order sought; an explanation of the need for relief, including all material facts and circumstances giving rise to the request; and the extent to which such relief is necessary or appropriate in the public interest and consistent with the protection of investors.

(2) Each application must be filed with the Secretary of the Commission at its Washington, D.C. headquarters, in either electronic or hard copy form, signed by an authorized representative of the board of trade, and labeled “Application for an Exemptive Order pursuant to Commission regulation 41.33.”



(d) Review Period.

(1) The Commission shall have 90 days upon receipt of an application for an exemptive order in which to make a determination as to whether such relief should be granted or denied.

(2) The Commission may request additional information from the applicant at any time prior to the end of the review period.

(3) The Commission may stay the review period if it determines that an application is materially incomplete; *provided, however*, that this paragraph (d) does not limit the Commission's authority, under paragraph (b) of this section, to decline to entertain an application.

(e) Upon conclusion of the review period, the Commission shall issue an order granting or denying relief, or granting relief subject to conditions; *provided, however*, that the Commission's obligations under this paragraph shall not limit its authority, under paragraph (b) of this section, to decline to entertain an application. The Commission shall notify the board of trade in writing of its decision to grant or deny relief under this paragraph.

(f) An application for an exemptive order may be withdrawn by the applicant at any time, without explanation, by filing with the Secretary of the Commission a written request for withdrawal, signed by an authorized representative of the board of trade.

(g) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Trading and Markets and the Director of the Division of Economic Analysis, jointly, with the concurrence of the General Counsel, authority to make determinations on applications for exemptive orders pursuant to this section; *provided, however*, that:

- (1) the Director of the Division of Trading and Markets or the Director of the Division of Economic Analysis may submit to the Commission for its consideration any matter which has been delegated pursuant to paragraph (g) of this section; and
- (2) nothing in this section shall be deemed to prohibit the Commission, at its election, from exercising the authority delegated to the Director of the Division of Trading and Markets and the Director of the Division of Economic Analysis under paragraph (g) of this section.

**§41.34 Exempt provisions.**

Any board of trade notice-designated as a contract market in security futures products pursuant to §41.31 of this chapter also shall be exempt from:

(a) the following provisions of the Act, pursuant to section 5f(b)(1) of the Act:

- (1) section 4c(c);
- (2) section 4c(e);
- (3) section 4c(g);
- (4) section 4j;
- (5) section 5;
- (6) section 5c;
- (7) section 6a;
- (8) section 8(d);
- (9) section 9(f);
- (10) section 16; and

(b) the following provisions, pursuant to section 5f(b)(4) of the Act:

- (1) section 6(a) of the Act;

(2) part 38 of this chapter; and

(3) part 40 of this chapter.

## **PART 140 – ORGANIZATION, FUNCTIONS, AND PROCEDURES OF THE COMMISSION**

5. The authority citation for Part 140 continues to read as follows:

**Authority:** 7 U.S.C. 4a and 12a.

6. Section 140.99(i) is amended by revising paragraphs (1) and (2) and adding new paragraph (3) as follows:

### **§140.99 Requests for exemptive, no-action and interpretive letters.**

\* \* \* \* \*

(i) \*\*\*

- (1) Notice filings required to be made to claim relief from the Act or from a Commission rule, regulation or order including, without limitations, §§4.5, 4.7(a), 4.7(b), 4.12(b), 4.13(b) and 4.14(a)(8) of this chapter;
- (2) Requests for exemption pursuant to section 4(c) of the Act; or
- (3) Requests for exemption pursuant to §41.33 of this chapter.

Issued in Washington, DC on August 20, 2001 by the Commission.

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Catherine D. Dixon  
*Assistant Secretary of the Commission*